

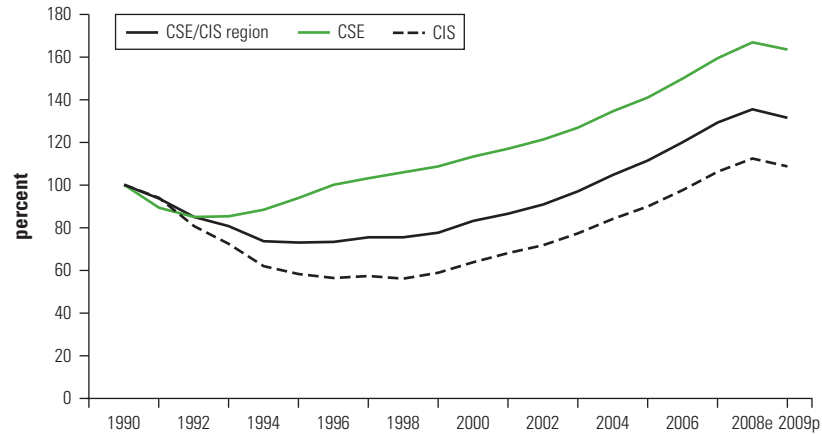
Introduction

Almost 20 years have passed since the transition process began in the countries of Central and South East Europe (CSE) and the Commonwealth of Independent States (CIS).¹ This transition can be characterized as reflecting three transitions rolled into one:

- A political transition, from a highly controlled centralized political system to a more decentralized and democratic form of government (in some countries this was combined with conflict and political disintegration)
- An institutional transition, from the institutional framework of central planning toward the institution of a market economy
- An economic transition, involving the disintegration of the highly integrated economic space of the former Soviet Union and the Council for Mutual Economic Assistance (CMEA/COMECON), with resultant disruptions in trade, financial, and labor market connections.

In each of these areas, there were broadly two stages of transition. The first was one of economic decline, involving the disintegration and destruction of existing political, institutional, and economic relations (figure 1.1). It was followed by recovery, involving rebuilding, reform, and integration with the world economy (recently, this stage has been affected by the global financial and economic crises).

FIGURE 1.1
Changes in Real Output in the Region, 1990–2008



Source: World Bank data base and staff projection.

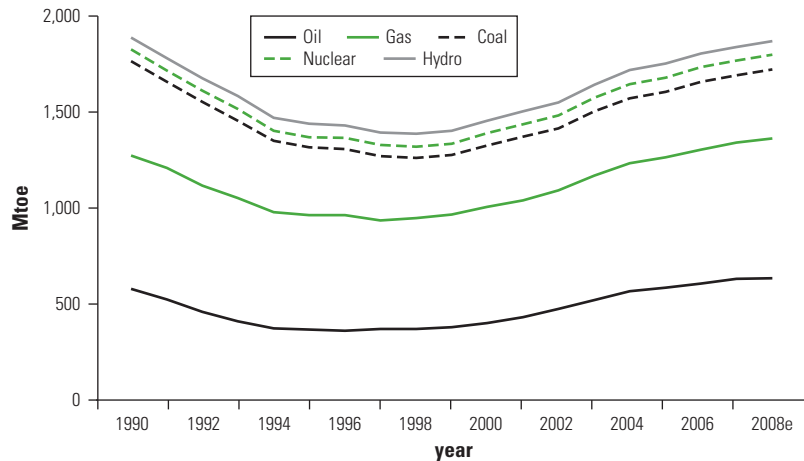
The region overall initially experienced six years of dramatic economic decline, starting in 1990, during which it lost a third of its measured GDP. It then stagnated for another three years, through 1998. Then, in 1999, a vigorous economic recovery began for the region as a whole. Taking advantage of access to global markets, the region subsequently experienced a rate of growth through 2007 that made it one of the most economically dynamic regions in the world. With the onset of the global financial and economic crises in 2008, the region's economic performance experienced a sharp reversal, with economic declines that were among the highest in the world.

This economic performance has been closely reflected in the region's energy sector. The initial economic decline was accompanied by a sharp reduction in both the production and consumption of energy. Primary energy production dropped steadily through 2000, to about 77 percent of its 1990 levels (figure 1.2). Since then it has increased, reaching 99 percent of its 1990 levels in 2008.

Consumption fell off even more sharply, dropping to 70 percent of 1990 levels in 1999 (figure 1.3). With the economic recovery that got underway at that time, consumption began to increase, but, given improvements in the level of energy intensity, consumption was still at only 80 percent of 1990 levels in 2008. This resulted in a steady growth in exports of primary energy (largely oil and gas), following an initial decline at the beginning of the transition period.

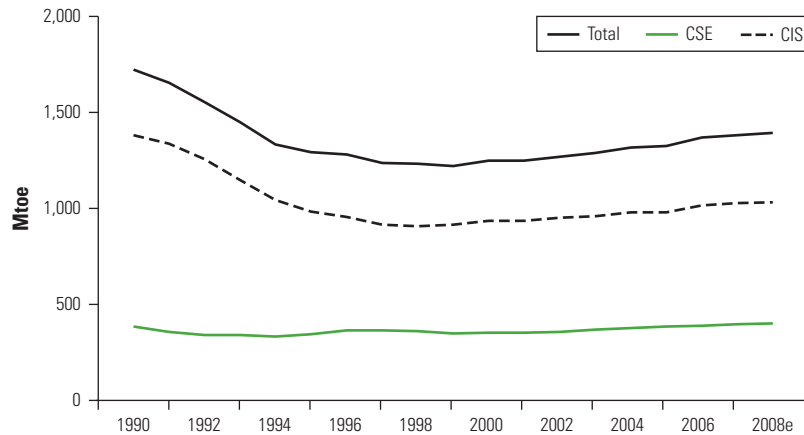
These trends suggest that the region should be amply endowed with energy supply. However, during the economic decline in the early part of the transition period, maintenance and upgrading of

FIGURE 1.2
Primary Energy Production in the Region, by Type, 1990–2008



Source: BP 2008.

FIGURE 1.3
Primary Energy Consumption in the Region, 1990–2008



Source: BP Statistical Review of World Energy 2008.

what had come to appear to be oversized infrastructure stock became an early investment casualty. The consequence was a steady deterioration in this stock of assets. At the time, the impact was minimal, but the deterioration in the asset base and the associated loss of both capacity and efficiency became an increasing concern as the economic recovery progressed. By the end of 2007, a number of countries in the region were experiencing periodic energy shortages, and a serious energy crunch appeared highly likely in the relatively near term.

The rapid rise in energy prices in 2008 followed by the onset of the financial and economic crises served to dampen energy demand significantly, creating some breathing room before energy availability again becomes a serious concern. But this is only a temporary respite—and one that may be truncated if governments do not accord adequate priority to asset preservation in allocating investment funds from a more limited envelope.

The disintegration of the highly integrated space of the former Soviet Union and the CMEA has also had an impact on the energy sector in the region. At the beginning of the transition period, the energy sectors of the various countries were heavily interdependent. The energy exporters (the Russian Federation and the Central Asian countries) relied on the energy-importing countries in the region as outlets for their primary fuel exports and, in a number of cases, as transit routes to access markets in Western Europe. The energy importers, in turn, were heavily dependent on Russia and, to a lesser extent, the Central Asian exporters for their primary energy supplies. In addition, within the region, supply chains had been designed to take advantage of the relative endowments of the various energy producers. Thus, in Central Asia, Kazakhstan, Turkmenistan, and Uzbekistan had been suppliers of oil and gas to the subregion, while the Kyrgyz Republic and Tajikistan had exported their surplus hydropower within the region.

Following the break-up of the Soviet Union, the focus steadily switched from an emphasis on optimization of energy production and distribution at the regional level to an emphasis on greater self-sufficiency at the individual country level. At the same time, energy exporters started to explore options to penetrate markets outside the region, while energy importers started looking at different supplier options for portions of their demand. The combination of these factors has resulted in some disintegration of the regional energy homogeneity that had existed in the region at the start of the transition period. Notwithstanding this, however, the region continues to experience considerable energy sector interdependence, which provides a basis for continuing to look at the energy outlook for the region as a whole while recognizing that, at the margin, countries are increasingly looking at options that will reduce this level of interdependence.

The current economic and financial crises have pushed some energy security concerns out of the limelight (although the issue of gas supply to Europe delivered via Ukraine remains very much a concern), but they remain key issues for countries in the region. Energy security, however, is an issue that requires a global response. An international agenda can perhaps best be developed by focusing on three

pillars: energy efficiency; diversification of energy supplies, in terms of both the source of supply and diversification among fuels; and strategies to manage price volatility. The challenge for individual countries in the region is how best to adapt their own energy strategies to incorporate these three pillars.

The impact of energy consumption on the environment is also an increasing concern, particularly for EU member countries and countries with EU aspirations that face the prospect of EU-mandated targets for 2020, which call for a 20 percent reduction in carbon emissions compared with 2005 and a 20 percent increase in the use of renewable energy by 2020. Environmental concerns have increased interest in nuclear power and intensified the emphasis on renewable energy sources.

The individual countries and the region as a whole are confronted with an energy outlook fraught with considerable uncertainties. But notwithstanding both these uncertainties and the current economic and financial situation, decisions will have to be made. These decisions will have long-term ramifications and may substantially affect the economic outlook at both the country and the regional level. It is, therefore, incumbent on policy makers to accord these decisions a considerable level of prioritization.

Notes

1. The countries covered are Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, FYR Macedonia, Georgia, Hungary, Kazakhstan, Kosovo, the Kyrgyz Republic, Latvia, Lithuania, Moldova, Montenegro, Poland, Romania, the Russian Federation, Serbia, the Slovak Republic, Slovenia, Tajikistan, Turkey, Turkmenistan, Ukraine, and Uzbekistan (sometimes referred to collectively as Europe and Central Asia).